

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
WESSON OIL AND SNOWDRIFT SALES CO.)

Appearances:

For Appellant; W. F. Hoerner, Secretary

For Respondent: Burl D. Lack, Chief Counsel;
Paul L. Ross and John L. Warren,
Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Wesson Oil and Snowdrift Sales Co, to a proposed assessment of additional franchise tax in the amount of \$5,355.90 for the taxable year ended August 31, 1949.

Appellant is a wholly owned subsidiary of The Southern Cotton Oil Company (hereinafter referred to as "Southern"). Southern manufactures outside of California vegetable oil products which Appellant sells in this State and elsewhere. It is undisputed that the activities of the two corporations are so closely integrated as to constitute each but a segment of a single unitary business. Since 1936 the California franchise tax liability of Appellant has, accordingly, been computed on the basis of consolidated reports of income of Appellant and Southern.

Under the method of doing business adopted by the two corporations Southern carries on its books all of the inventories of the unitary business. During the income year ended August 31, 1948, Southern sold to out-of-state purchasers approximately 47 percent of its raw and semi-raw vegetable oil inventory for an aggregate gross sales price of \$14,520,000, **on** which it realized a profit of \$12,000,000. In computing its proposed assessment of additional tax the Franchise Tax Board has included this profit in allocable income of the unitary business,

In computing its California tax for the year in question Appellant omitted from allocable net income the profit realized on the sales of inventory, but it included the gross sales price in the sales factor of the allocation formula as out-of-state sales. It has since conceded that if the profit

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from the sales is not includible in allocable income, the sales price must likewise be excluded from the sales factor. It has, accordingly, paid additional tax in the amount of \$1,187.73, thereby reducing the amount in controversy in this appeal to the sum of \$4,188.17,

On August 31, 1941, Southern adopted the last-in, first-out (LIFO) inventory method for tax purposes. In 1943 it elected to make an adjustment for the excess of replacement costs of its inventory involuntarily liquidated in the year ended August 31, 1943. (See Section 224d)(6), U. S. Internal Revenue Code of 1939). Each of these inventory transactions by Southern was reflected by a decrease in unitary income and substantially reduced Appellant's California franchise tax liability for the years in which the transaction occurred. It was these transactions also which were responsible for the low basis for the inventory liquidated in 1948, and the resulting large gain realized on the sales in question.

Notwithstanding the obviously close relationship between inventory and income of the unitary business, Appellant contends that no part of net income realized on the 1948 sales of inventory is subject to allocation. It has failed, however, to direct our attention to any authority in support of this position and merely asserts that (1) the sales were made to purchasers located without California and (2) the sales were extraneous transactions different in nature from the normal business operations of Appellant and Southern,

Where a taxpayer's business in California is part of a unitary business carried on within and without the State, the entire net income of the unitary business is subject to allocation to determine the portion thereof derived from or attributable to sources within this State. Butler Brothers v. McCogan, 17 Cal. 2d 664, affirmed 315 U.S. 501. Thus, without regard to the place at which the sales took place, if the transactions occurred in the course of the unitary business operations of Appellant and Southern, the income realized thereon is subject to allocation,

The inventory of vegetable oils held by Southern was acquired to meet the needs of the unitary business. Its partial liquidation was dictated by considerations arising in the unitary business. The acquisition and storage of the inventory, and the accounting involved therein, were carried out in the ordinary course of the unitary business through the use of personnel and facilities of the unitary business. Every transaction involving inventory is ultimately reflected in the gross profits of the unitary business. Upon these facts, we experience no difficulty in concluding that the transactions

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in question were so integrated with the unitary business as to constitute them a part of that business. We are of the opinion, therefore, that the action of the Franchise Tax Board should be sustained.

O R D E R

Pursuant to the views expressed in the opinion of the Board *on file* in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Wesson Oil and Snowdrift Sales Co, to a proposed assessment of additional franchise tax in the amount of \$5,355.90 for the taxable year ended August 31, 1949, be and the same is hereby affirmed,

Done at Sacramento, California, this 5th day of February, 1957, by the State Board of Equalization,

Robert E. McDavid, Chairman

George R. Reilly, Member

Paul R. Leake, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary